



PREVENTIVE LAW SERIES  
**PREDATORY LENDING**



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## **PREDATORY LENDING**

There are no legal definitions in the United States of predatory lending; however, there are laws against many of the specific practices commonly identified as predatory, and various federal agencies use the term as a catch-all term for many specific illegal activities in the loan industry. Types of lending sometimes referred to as "predatory" include payday loans, credit cards, revolving credit, and rent-to-own schemes where the interest rates are considered unreasonably high. Predatory lending often occurs on loans backed by some kind of collateral - such as a car or house - so that if the borrower defaults on payment, or even if he doesn't default, the lender can repossess or foreclose and profit by selling the repossessed or foreclosed property.

## **ABUSIVE LENDING PRACTICES**

There are many lending practices which have been called "abusive" and labeled with the term "predatory lending." There is a great deal of dispute between lenders and consumer groups as to what exactly constitutes "unfair" or "predatory" practices, but the following are sometimes cited:

- a) *Risk-based pricing* - This is the practice of charging more (in the form of higher interest rates and fees) for extending credit to borrowers identified by the lender as posing a greater credit risk. The lending industry argues that risk-based pricing is a legitimate practice; since a greater percentage of loans made to less creditworthy borrowers can be expected to go into default, higher prices are necessary to obtain the same yield on the portfolio as a whole. Some consumer groups argue that higher prices paid by more vulnerable consumers cannot always be justified by increased credit risk.
- b) *Single premium credit insurance* - This is the purchase of insurance which will pay off the loan in case the homebuyer dies. It is more expensive than other forms of insurance because it does not involve any medical checkups, but customers almost always are not shown their choices, because usually the lender is not licensed to sell other forms of insurance. In addition, this insurance is usually financed into the loan which causes the loan to be more expensive, but at the same time encourages people to buy the insurance because they do not have to pay up front.
- c) Any situation where a *loan price is negotiable and the buyer is not made aware of their ability to negotiate*, and might even be under the mistaken impression that the lender is placing the borrower's interests above its own. Thus, many borrowers do not take advantage of their ability to negotiate.
- d) *Short-term loans with proportionally high fees*, such as payday loans, credit card late fees, checking account overdraft fees, and Tax Refund Anticipation Loans, where the fee paid for advancing the money for a short period of time works out to an annual interest rate significantly in excess of the market rate for high-risk loans. The originators of such loans dispute that the fees are interest.

## **RESOURCES**

15 U.S.C. §§ 1604 and 1637(c)(5)  
12 CFR §226

Rev. March 2016